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Consultation Paper – Living-away-from-home (LAFH) benefits

The Australian Petroleum Production & Exploration Association (APPEA) is the peak national body representing Australia's oil and gas exploration and production industry. APPEA has 90 full member companies exploring for and producing Australia's oil and gas resources. The companies currently account for around 98 per cent of Australia's total oil and gas production and the vast majority of exploration. APPEA also represents over 200 companies providing a range of goods and services to the industry. Further details about APPEA can be found at our website at www.appea.com.au.

The Australian petroleum exploration and production industry is an integral part of the Australian economy. The industry's direct contribution includes:

- the supply of reliable, clean, efficient energy supplies for households and industry;
- employment of tens of thousands of Australians;
- regional investment;
- export income (and the replacement of imports); and
- payment of significant amounts of government tax revenues.

In addition, substantial indirect benefits flow from the industry, including benefits to the national and state economies via a growing services and contractor sector.

Preliminary Observations and Key Issues

As a general principle, governments should seek to tax the outputs of industry, and seek to remove taxes on business inputs - this was the underlying rationale for the introduction of the GST in 2000. Taxes on business inputs are taxes on investment, not profits, and an inefficient means of raising revenue which detracts from a competitive investment environment.

Internationally mobile workforces are an increasingly important component of the global labour force. The ability to deploy highly skilled resources rapidly in the most effective way is particularly vital in the oil and gas sector, where key skills can be required at short notice. Providing accommodation assistance in host locations is a standard component of global expatriate policies. In this context, Australian oil and gas companies compete for a global pool of talent against countries who have lower

income tax rates and generally lower costs of living. The labour component of project costs in Australia is already high. Removing tax exemptions in respect of temporary residents, would impose further pressure on labour costs.

Temporary residents are recruited into Australia because there is often no local Australian with the skills or availability to fill the role. The proposed LAFH reforms will not stop these temporary resident employees being recruited – indeed the immigration visa process is designed to establish that there is a genuine need for them. The proposed LAFH reforms would simply add a further tax impost and compliance burden on businesses already struggling to maintain international competitiveness.

A tax regime that increases the relative cost of international labour movements will negatively impact on both the mobility of labour and our international competitiveness as an investment destination. In most countries, there is recognition that employer provided accommodation for foreign nationals should be either exempt or taxed at a nominal value. In this context, it is recommended that living away from home concessions for foreign nationals should continue to apply to those employees who are genuinely living away from home.

Further, the exempt accommodation component of a LAFH allowance is that portion which it is reasonable to conclude is compensation for additional expenses on accommodation that the employee could reasonably be expected to incur. Under the proposed reforms, a domestic worker who is living away from home will be entitled to concessional treatment of their additional accommodation expenses incurred either through the fringe benefits tax or income tax regime. It is reasonable to expect an international worker coming to work in Australia would also incur additional accommodation expenses as a result of them living away from home and they should therefore also be entitled to similar financial outcome.

APPEA understands that the proposed reforms seek to address the use of the LAFH benefits in circumstances not intended at a policy level – in particular, tax free income to individuals to subsidise presumed costs they are not in fact incurring. We are supportive of the original policy intention underpinning the LAFH concession and understand the Government taking steps to rectify unintended usage of them. However, the proposed change is so broad it will also create a tax burden in respect of employees who genuinely fall within the core policy intent of the LAFH concessions. A narrower more targeted response can be achieved to address the Government's concerns without unfair discrimination in terms of the individual's country of origin.

Temporary resident employment contracts are likely to be fixed for a period of up to four years and as the proposed reforms stand, there will be no grandfathering or transitional treatment for existing arrangements. In many circumstances, employers will be required to absorb the tax cost to ensure the after tax pay of the temporary employees remains consistent. In addition, all existing supplier arrangements will need to be reviewed and this will impact on contract values and project budgets.

Specific Comments on the Consultation Paper

1. Are there any unintended consequences from the proposed reforms?

As indicated above, if implemented as drafted, abolishing the LAFH benefit for foreign nationals will have a significant impact on the ability of Australia to attract highly skilled foreign labour in a time of increasing skills shortages (particularly in the resources sector). Australia's high individual rates, rents and overall costs of living do not compare favourably with industry and regional competitors. This will inevitably put additional upward pressure on wages in order to attract and/or retain foreign workers in Australia (together with the on-costs associated with the payment of salaries and wages).

A temporary resident who does not maintain a home for their use in Australia which they are required to live away from for work will be disadvantaged by having FBT concessions regarding school fees and home travel abolished. With the exception of visitors from countries with Reciprocal Health Care Agreements, most temporary residents receive no education or medical assistance from the government while here in Australia and a further financial burden will be imposed on their families for education and travel. Most countries provide some concessions for employer provided accommodation for employees temporarily living away from home.

The removal of concessionally taxed accommodation will not stop Australian employers requiring skilled overseas labour. Incentives to work in Australia will still be required. To retain skilled employees, many employers will need to absorb the tax cost under the proposed reforms either through paying FBT on expense payment benefits, or by absorbing the impact of an increase in tax on LAFH allowances by ensuring after tax pay remains consistent. Some employers will have no choice as tax stability (protection from movements in tax rates) is common in many expatriate contracts. In addition, supplier contracts will all have to be reviewed to determine the nature of tax stability clauses and the impact additional labour costs will have on contract values and project budgets.

The Consultation Paper states one of the reasons for the reform is the inequitable treatment that has arisen between employees. The proposed changes appear to create an imbalance in the other direction, such that temporary residents are disadvantaged versus permanent residents. APPEA understands that the proposed new provisions will apply as follows:

	Permanent Resident	**Temporary Resident**
Allowance received for LAFH	Included in assessable income, deduction allowable for substantiated accommodation expenses, and food up to statutory limit	Included in assessable income, deduction only allowed if the taxpayer maintains a home in Australia which is available for use any time (cannot be rented out or sub-let)

LAFH accommodation benefits: provided directly or as a reimbursement	FBT exempt for actual accommodation expenses and food amounts within a statutory limit	FBT exempt as for permanent resident, provided the taxpayer maintains a home in Australia which is available for use any time (cannot be rented out or sub-let)

The proposed tax treatment disadvantages the temporary resident due to the requirement to maintain an 'available' home in Australia whilst also living away from that home, in Australia. Practically, due to time limits on visas and the nature of assignments, many expatriates continue to maintain a home in the home country, but this cannot be taken into consideration under the proposed reforms.

A permanent resident is not required to show their home is available whilst on assignment. The permanent resident has an advantage as they are not required to show their usual place of residence is available for their sole use, and could benefit from the arrangement if they are able to rent out or sub-let their usual place of residence whilst receiving tax free accommodation in the host location.

2. What practical aspects of the proposed reforms need further consideration?

The proposed reforms will require additional record keeping for employers who provide accommodation as a fringe benefit. Previously, an employer would only be required to obtain evidence of the expense incurred and a declaration. Under the reforms, an employer will be required to:

- track the residency status of an employee – what records are required to show an employee is a permanent resident versus temporary?
- obtain evidence from temporary residents that they maintain a home from which they live away, which is also available for use by the employee while they live away from home. What tangible evidence is required to show a residence is 'available' and not occupied?

Extra documentation requirements mean increased risk to the employer of incorrectly claiming an FBT exemption. Upgrades to record-keeping systems will cost both directly, in terms of software and systems, and indirectly in terms of man-hours, training on new rules etc. Further thought is required on privacy issues. For example, an employee is required to show their usual place of residence is vacant while they are living away from home and an employee is required to declare a cohabitation arrangement with a fellow employee. Payroll systems will need to be modified to allow a LAFH to be treated as an allowance subject to PAYG withholding rather than a fringe benefit.

It is reasonably expected that most current employment contracts and rental agreements will have a duration beyond the proposed introduction date. There should be a grandfathering of existing contracts entered into before the announcement of the proposed reforms (29 November 2011), particularly when it is recognised that there was a four year transition period for the recent changes to the

statutory formula method for car fringe benefits. In addition, there is an insufficient timeframe between the release of the legislation and its start date to deal with complexities of the LAFH allowance moving from a fringe benefit to an income tax treatment.

There is uncertainty regarding the treatment of a temporary resident who shares their 'available' home in Australia with another occupant who pays rent, in circumstances where the other occupant remains in the home while the temporary resident is working elsewhere. This raises the question of whether it would breach the requirement that it "cannot be rented out or sub-let while they are living away from home". If it is the case that no other person is permitted to occupy the home, this would create an additional burden for employers to obtain evidence of such circumstances.

Furthermore, MT 2030 states that there should be an intention or expectation that the employee will return to live at their former place of residence after completing their work at the temporary location (paragraph 14). For foreign workers, this would ordinarily mean that they would return to their country of origin after a period of time. However there is lack of clarity about whether this expectation also applies to the home maintained in Australia for own use (i.e. is it expected that temporary residents return to their home maintained for their use after their temporary work is complete?). If the foreign worker is expected to return to their 'available' home, it would be difficult to provide evidence of this future intention, and it raises further questions about how long they would be required to stay at that home. On the other hand, if the foreign worker is not expected to return to their home maintained in Australia, it would seem unreasonable to require a temporary resident to maintain an 'available' home in the first place.

3. *Are there any interactions with other areas of tax law that need to be addressed?*

Currently, LAFH allowances are a fringe benefit and therefore specifically exempt from the definition of salary and wages for superannuation guarantee purposes. It is unclear whether moving such allowances to income tax means that expense allowance LAFH allowances (a portion or all) would be included in the definition of salary and wages and ordinary times earnings when calculating an employer's superannuation guarantee obligation. It is recommended that should the proposed reforms proceed, superannuation guarantee ruling SGR 2009/2 be updated to allow a LAFH allowance, where paid as an expense allowance, to be excluded from the definition of salary and wages for superannuation guarantee purposes. In addition, it is not clear whether education costs will be included for the purposes of calculating state and territory payroll taxes.

4. *As the statutory food amount is intended to reflect the ordinary costs incurred by an Australian in 2011, what should the statutory food amount be updated to?*

The current statutory food amount which is $42 for persons aged 12 and over, and $21 for persons less than 12 years of age, was set in 1986. These amounts should be updated based on the most recent data from the Australian Bureau of Statistics

(ABS). Given that the latest Household Expenditure Survey undertaken by the ABS was for 2009-10, the data from this survey can be indexed to reflect the costs that would have been incurred by an Australian in 2011. This approach would be consistent with the approach taken for the statutory food amount in relation to expatriate employees, where the food component of LAFH allowance for expatriate employees was initially based on the 1984 ABS Household Expenditure Survey, and has since been indexed each year. In any event, there will be additional administrative costs imposed on employers.

5. *Should the statutory food amount be indexed annually to ensure it remains up to date?*

Currently, the statutory food amount is only indexed annually for expatriate employees (as mentioned above). To ensure consistency, it would also seem reasonable to index the statutory food amount for other employees receiving LAFH allowance benefits. Indexation is also appropriate given that the cost of food can change significantly over time. Data from the ABS indicates that the percentage change in food and non-alcoholic beverages sub-group in Australia between 2007 and 2011 has been up to 6.4% from the corresponding quarter of the previous year (Source: Publication 6401.0 – Consumer Price Index, Australia).

However, annual indexation leads to more record keeping and systems changes – if the amount is indexed annually according to the FBT year of April - March, will individuals who are tracking expenditure to claim an income tax deduction on their LAFH food allowances be required to perform a split calculation – i.e. from 1 July – 31 March, then from 1 April – 30 June, based on changes to indexation part way through the income tax year? If the indexation date is 1 July, then the indexed rates are split across FBT years. Will two FBT calculations be required for each employee each FBT year on a pro-rata basis? These issues require further clarification if the statutory amount will be indexed annually.

6. *What transitional arrangements would be appropriate for the community sector?*

It is unclear why transitional arrangements should be limited to the community sector. The quick implementation envisaged in the Consultation Paper will disadvantage employers with contracts where employees are 'tax protected' as employers are required to absorb any tax increase. It will also disadvantage employees with long-term accommodation agreements that were entered into under the existing LAFH allowance provisions.

APPEA supports in principle reforms that seek to effectively achieve the objectives of curbing the exploitation of LAFH benefits - for temporary residents and local Australians alike. The Consultation Paper and proposed reforms as they stand are unnecessarily discriminatory and have the ability to negatively impact upon the Australian economy and will result in a direct tax cost to many of our members.

APPEA would be pleased to further expand on the issues raised above. Contact officer in the first instance in APPEA is Noel Mullen (nmullen@appea.com.au).

Yours sincerely

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Chief Executive